

Internal Revenue Service

Number: **200850003**

Release Date: 12/12/2008

Index Number: 141.01-00, 141.01-04

Department of the Treasury

Washington, DC 20224

[Third Party Communication:

Date of Communication: Month DD, YYYY]

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PLR-108471-08

Date:

August 25, 2008

LEGEND

ISO =

Bonds =

Agency =

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Dear :

This is in response to your request for a ruling that the implementation by the ISO of a new congestion management system for transmission facilities financed with the proceeds of the Bonds will not be treated as a deliberate action that causes the Bonds to be private activity bonds under § 141 of the Internal Revenue Code of 1986 (the “1986 Code”) or industrial development bonds under § 103(b) of the Internal Revenue Code of 1954 (the “1954 Code”).

FACTS AND REPRESENTATIONS

The Agency is a joint powers agency and a public entity organized under the laws of the State. Agency has a members, each of which is a political subdivision of the State. The Agency’s outstanding Bonds financed or refinanced costs associated with several electric power transmission projects (the “Facilities”). Some of the Bonds are subject to the 1986 Code and others are subject to the 1954 Code. The Agency has chosen to apply § 1.141-7(g) of the Income Tax Regulations to the Bonds, as permitted under § 1.141-15(i).

The Energy Policy Act of 1992, P.L. 102-486(October 24, 1992) and various orders of the Federal Energy Regulatory Commission (the “FERC”), including Order Number 888 and Order Number 2000 (referred to as “open access”), were promulgated in the early 1990s to bring about increased competition at the wholesale energy level, and, thereby, reduce the cost of wholesale electric energy. To achieve this purpose, the FERC in Order Number 888 required, among other items: (1) the provision of open access transmission services on a non-discriminatory basis by all FERC-jurisdictional utilities that own, operate, or control interstate transmission facilities, and (2) that a non-FERC-jurisdictional utility that purchases transmission services from a FERC-jurisdictional

utility and that owns or controls transmission facilities must make available open access transmission service to the FERC-jurisdictional utility under terms that are comparable to the service the non-FERC-jurisdictional utility provides itself. In Order Number 2000 the FERC required, among other items, each FERC-jurisdictional utility to make certain filings with the FERC with respect to forming and participating in a regional transmission organization which includes independent system operators. Order Number 2000 provided the required characteristics for regional transmission organizations such as independence, scope and regional configuration, operational authority, and short-term reliability.

Although the Agency and its members are not subject to the jurisdiction of the FERC under §§ 205 and 206 of the Federal Power Act, 16 U.S.C. 824e (2001) (the “Act”), several of the Agency’s members signed an agreement (the “Agreement”) to become members of the ISO, a nonprofit public benefit corporation that provides non-discriminatory access to the transmission facilities of its members. Accordingly, the transmission capacity held by those Agency members is now under the operational control of the ISO. In PLR 200240028, we ruled that the joining of the ISO by the members would not be treated as a deliberate action that causes the Bonds to be either private activity bonds under § 141 of the 1986 Code or industrial development bonds under § 103(b) of the 1954 Code.

The ISO participants hold the rights to transmission capacity of transmission facilities that they have placed under the operational control of the ISO (the “ISO grid”). The ISO was created to provide open and nondiscriminatory access to the ISO grid pursuant to a transmission tariff, which has been approved by the FERC as being consistent with its rules. Under the transmission tariff, the ISO allocates the transmission capacity under its operational control and collects fees from the recipients. If the capacity of the ISO grid exceeds demand, access to the ISO grid is open to all entities seeking transmission service. When transmission demand exceeds capacity, congestion occurs and the ISO must implement a congestion management system.

Currently the ISO employs a congestion management system known as firm transmission rights or financial transmission rights (“FTRs”). The holders of FTRs with respect to a transmission line have first priority to use of the transmission line during times of congestion. To the extent that holders of the FTRs do not exercise their priority rights during times of congestion, access is given to those willing to pay the highest usage fees in addition to the other standard fees for use of the transmission lines. In other words, during times of congestion, the holder of an FTR will either use the transmission line or collect the premium paid by the entity who uses the transmission lines. The ISO distributes substantially all of the usage fees to the FTR holders to the extent they did not exercise their priority rights.

The ISO determines the amount of FTRs to be assigned to each transmission line subject to usage fees and allocates the FTRs among the ISO participants that hold the

rights to transmission capacity along the transmission line. The ISO also sells a pro rata portion of each participant's FTRs at auction where such FTRs may be purchased by anyone for a one-year period. After the one-year period has expired the ISO places the FTRs up for auction again. The ISO participants who have been allocated the FTRs receive the proceeds of the auctions.

In PLR 200542032, we ruled that permitting the sale of FTRs with respect to transmission facilities financed with the proceeds of the Bonds is not treated as a deliberate action that causes the Bonds to be either private activity bonds under § 141 of the 1986 Code or industrial development bonds under § 103(b) of the 1954 Code.

In support of PLR 200542032, the Agency represented that: (1) each member retained all the benefits of ownership and its rights and responsibilities in relation to its own transmission lines and facilities that it placed under the operational control of the ISO; (2) the ISO exercises operational control for purposes limited under the Agreement; and (3) the compensation earned by the ISO is limited to the grid management charge that is intended to only recover annual operating expenses and capital costs without a profit. In accordance with the Agreement and additional ISO operating protocols, the member must operate and maintain its transmission facilities. Additionally, a member is liable for the risk of loss of its transmission facilities unless the damage is directly caused by the negligent performance of the ISO.

In 2000, the FERC concluded that the current ISO congestion management system was fundamentally flawed and directed the ISO to design a comprehensive, replacement congestion management approach. In response, the ISO designed a new congestion management system (the "New System"). The FERC provided substantial guidance to the ISO in the development of the New System, including the replacement of the FTR model with a Congestion Revenue Right (CRR) model. The FERC has conditionally accepted the New System and the ISO expects to begin the implementation of the New System shortly.

The CRR system is fundamentally different from the original FTR system. The FTR system was a zonal system under which the State was divided into three large zones and congestion between zones was managed through the use of the FTRs. The FTR system assumed that congestion within a zone would be minimal in scope and cost. Because, in fact, intra-zonal congestion is common, the New System is a nodal system under which each node represents a generation or load point on the transmission grid. Under the New System a locational marginal price (an "LMP") will be calculated for each node in the day-ahead and real-time energy markets in an amount equal to the least marginal cost of supplying the next increment of electrical demand at such nodes. Such LMP will take into account the costs of available generation, physical limitations of the transmission system such as congestion, and other operating constraints against a previously determined baseline. As a result, the LMP at the node at which energy is injected into the grid may be different from the LMP at the node where energy is removed from the grid.

CRRs are financial instruments that represent the differential between the cost of energy at a starting point, or source, and the cost of energy at an ending point, or sink. For most CRRs, known as CRR Obligations, if the LMP with respect to a source node is less than with respect to the sink node, the holder of a CRR will be entitled to a payment representing the difference. On the other hand, if the LMP with respect to the sink node exceeds the LMP with respect to the source node, the holder of the CRR will be obligated to make a payment to the ISO.

CRRs will be made available through an allocation process and an auction process. During a transition period, members of the Agency will be allocated CRRs that will provide such members with a perfect hedge for balanced schedules of energy for the day-ahead market submitted to the ISO. In addition, during the transition period such members will receive scheduling priority. At the end of the transition period, the members expect that they will have the priority right to receive an allocation of their CRRs.

The Agency represents that implementation of the New System will not significantly affect the legal arrangement between the Agency members and the ISO as governed by the Agreement. Specifically the Agency represents that following the implementation of the New System each Agency member: (1) continues to retain all benefits of ownership and its rights and responsibilities in relation to its own transmission lines and facilities that it places under the operational control of the ISO; (2) must continue to operate and maintain its facilities in accordance with the Agreement and additional ISO operating protocols; (3) retains the right to dispose of its transmission facilities or entitlement to capacity, subject to two-years' notice to the ISO and the consent of the ISO, which consent may not be unreasonably withheld; (4) remains liable for the risk of loss of its transmission facilities unless the damage is directly caused by the negligent performance of the ISO; and (5) remains entitled to receive annually from the ISO its transmission revenue requirements ("TRRs"). TRRs are approved by the FERC and include depreciation costs and costs of carrying each member's transmission facilities, costs of operations and maintenance, and a reasonable rate of return. The TRRs are paid by the ISO from transmission access charges that are approved by the FERC and are assessed to users accessing the ISO controlled grid.

Further, the Agency represents that the ISO's compensation continues to be limited to the grid management charge, which is intended only to recover annual operating expenses and capital costs without profit, and that it continues to exercise operational control of the facilities only for the limited purposes under the Agreement.

LAW AND ANALYSIS

Under § 103(a) of the 1986 Code, gross income does not include interest on any state or local bond. Section 103(b)(1) provides that interest on a state or local bond is not

excluded from gross income if the bond is a private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) defines the term private activity bond to mean any bond issued as part of an issue which meets either (1) the private business use test and the private security or payment test (the “private business tests”), or (2) the private loan financing test.

Section 141(b)(1) states that except as otherwise provided, an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(2) provides that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property used or to be used for a private business use, or in payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(b)(6)(B) defines private business use to mean use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Section 141(b)(6)(A) provides that use as a member of the general public is not taken into account.

Section 1.141-2(d)(1) provides that an issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either the private business use tests or the private loan financing test. Section 1.141-2(d)(1) further provides that an issue is also an issue of private activity bonds if the issuer takes a deliberate action, subsequent to the issue date, that causes the conditions of the private business tests or the private loan financing test to be met.

Sections 103 and 141 through 150 of the 1986 Code were enacted by § 1301 of the Tax Reform Act of 1986, 1986-3 C.B. (Vol 1) 1, 519. Interest on bonds which are not subject to § 1301 may be excluded from gross income under 103 or 103A of the 1954 Code, which provide similar rules.

Section 1.141-7(g)(4)(ii) provides that an action is not treated as a deliberate action under § 1.141-2(d) if it is taken to implement the offering of nondiscriminatory, open access tariffs for the use of electric transmission or distribution facilities in a manner consistent with rules promulgated by the FERC under sections 205 and 206 of the Federal Powers Act, 16 U.S.C. 824d and 824e (or comparable provisions of state law).

Section 1.141-7(g)(4)(ii) does not apply, however, to the sale, exchange, or other disposition (within the meaning of section 1001(a)) of transmission or distribution facilities to a nongovernmental person. Section 1.141-15(i) allows issuers to apply § 1.141-7(g) to any bonds.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Incidents of ownership includes: (1) legal title, (2) contractual duty to pay for capital investment, (3) responsibility to pay maintenance and operating costs, (4) duty to pay taxes, (4) risk of loss, and (6) risk of diminution of value. See Revenue Ruling 79-264, 1979-2 C.B. 92. The benefits and burdens indicative of ownership include: (1) right to possession, (2) obligation to pay taxes, (3) responsibility to insure property, (4) duty to maintain property, (5) right to improve property, (6) risk of loss, and (7) legal title. See Keith v. Commissioner, 115 T.C. 605, 611-12 (2000).

At the FERC's direction, and under its guidance and approval, the implementation of the New System including the conversion to the CRR congestion management model is being undertaken to enhance and further the goal of providing open and non-discriminatory access to transmission assets consistent with the rules promulgated by the FERC. Moreover, because the Members will retain the entitlements and burdens associated with the ownership of the Facilities, there will be no sale, exchange or other disposition of the Facilities under § 1001. Therefore the implementation of the New System including the conversion to the CRR congestion management model is an action described in § 1.141-7(g)(4)(ii) and will not be treated as a deliberate action under § 1.141-2(d).

CONCLUSION

Based on the foregoing, we conclude that the implementation by the ISO of the New System with respect to the Facilities will not be treated as a deliberate action that causes the Bonds to be private activity bonds under § 141 of the 1986 Code or industrial development bonds under § 103(b) of the 1954 Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the 1986 Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Timothy L. Jones
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(Financial Institutions & Products)